

Alfred Nzo District Municipality

Audit Report

For the year ended 30 June 2017

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Alfred Nzo District Municipality

Report on the audit of the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of the Alfred Nzo District Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2017, and the consolidated and separate statement of financial performance, statement of changes in net assets, and cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this report, consolidated and separate financial statements present fairly, in all material respects, the financial position of the Alfred Nzo District Municipality as at 30 June 2017 and its financial performance and cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for qualified opinion

Property, plant and equipment

3. The municipality did not account for property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*, as disclosed in note 3. The following deficiencies were identified:
 - Some infrastructure assets were not recorded in the fixed asset register
 - The fixed asset register was inconsistent with the annual financial statements.
4. As a result infrastructure assets, disclosed in note 3 to the consolidated and separate financial statements, are understated. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of infrastructure assets. Consequently, I was unable to determine the adjustment required to infrastructure assets of R1,7 billion, as disclosed in note 3 to the consolidated and separate financial statements.
5. In my previous audit report, I reported that the municipality did not comply with the requirements of GRAP 17, *Property, plant and equipment* relating to the categorisation of assets. Completed assets were also not transferred to infrastructure assets from assets under construction. Management did not correct the misstatements identified. As a result, the corresponding figure for infrastructure assets disclosed in note 3 is understated by R108,1 million and the corresponding figure for assets under construction, as disclosed in note 3, is overstated by R108,1 million.

Irregular expenditure

6. The municipality did not have adequate systems to identify and disclose all irregular expenditure during the year, as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure for the year under review and the previous year, disclosed in note 51 to the consolidated and separate financial statements, is understated. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of the irregular expenditure. Consequently, I was unable to determine the adjustment required to the irregular expenditure of R593,3 million (2016: R591,2 million), disclosed in note 51 to the consolidated and separate financial statements.

Commitments

7. *GRAP 17, Property, plant and equipment* requires the disclosure of contractual commitments for the acquisition on property, plant and equipment. An adequate record of commitments was not maintained and reviewed for accuracy and completeness by the municipality for the year under review. Invoices inspected were inconsistent with the disclosed amounts, retentions were incorrectly included in the commitments register and some commitments have not been recorded in the register. This resulted in an overstatement of R130,8 million (2016: R83,8 million) of commitments disclosed in note 43 to the consolidated and separate financial statements.
8. My 2015-16 report contained a modification relating to commitments because I was unable to obtain sufficient appropriate evidence that commitments were properly accounted for. Management did not correct the matters giving rise to the modification. As a result, I was again unable to obtain sufficient appropriate audit evidence that the corresponding figure for commitments was adequately supported. I was unable to confirm this corresponding figure by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the corresponding figure for commitments disclosed at R1,3 billion in note 43 to the consolidated and separate financial statements.

Context for the opinion

9. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the separate financial statements section of my report.
10. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
11. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty

12. As disclosed in note 49 to the consolidated and separate financial statements, the municipality is facing a number of financial risks that cast doubt on its ability to sustain its current level of operations in the near future. The key financial risks identified include:

- an inability to pay creditors within due dates
- negative key financial ratios including a net current liability position.

In addition, the actions taken by management to mitigate the impact of these risks are disclosed in this note.

Emphasis of matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

14. As disclosed in note 46 to the separate financial statements, the corresponding figures for 30 June 2016 have been restated as a result of an error discovered during 30 June 2017 in the separate financial statements of the municipality at, and for the year ended, 30 June 2016.

Material losses

15. As disclosed in note 11.1 to the separate financial statements, material losses of R86 million (2016: R53,5 million) were incurred as a result of water losses.

Fruitless and wasteful expenditure

16. As disclosed in note 50 to the separate financial statements, fruitless and wasteful expenditure of R17 million not yet condoned. Fruitless and wasteful expenditure of R378 644 was incurred during the year under review as a result of interest payments.

Unauthorised expenditure

17. As disclosed in note 49 to the separate financial statements, unauthorised expenditure of R33,5 million was incurred in the year under review, and not yet condoned.

Other matter

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion thereon.

Accounting officer's responsibility for the consolidated and separate financial statements

20. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA, and for such internal control as the accounting officer determines is necessary to enable the preparation of the

consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

21. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the Alfred Nzo District Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the consolidated and separate financial statements

22. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
23. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

24. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
25. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
26. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected programmes presented in the annual performance report of the municipality for the year ended 30 June 2017:

Programmes	Pages in the annual performance report
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Programme 2: basic service delivery	x – x
Programme 5: local economic development	x – x

27. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
28. I did not raise any findings on *Programme 5: Local economic development*. The material findings in respect of the usefulness and reliability on *Programme 2: Basic service delivery* are as follows:

Programme 2: basic service delivery

Usefulness

29. Indicators and targets were not well-defined and verifiable. I was unable to obtain sufficient appropriate evidence that clearly defined the predetermined source information, evidence and method of collection to be used when measuring the actual achievement for the indicators was clearly defined, as required by the Framework for managing programme performance information (FMPPI). This was due to a lack of technical indicator descriptions and formal standard operating procedures or documented system descriptions. I was unable to test whether the indicators were well-defined and verifiable by alternative means.

Indicator number	Description	No of indicators
11.3.2.1.4	% completion of packaged Water Treatment Plant	1
(11.3.2.1.5,11.3.2.1.8, 11.3.2.1.15, 11.3.2.1.11)	Number of boreholes equipped	3
(11.3.2.1.6, 11.3.2.1.9,11.3.2.1.14, 11.3.2.2.7)	Number of pump stations Constructed	4
(11.3.2.1.7)	Number villages provided with reticulation network and secondary mains plus 5 reservoirs.	1

(11.3.2.1.10,11.3.2.1.16,	Number of reservoirs constructed	2
(11.3.2.1.12)	Kilometres of bulk rising main completed	1
(11.3.2.1.17,11.3.2.1.18, 11.3.2.1.19, 11.3.2.1.20, 11.3.2.1.21, 11.3.2.1.22, 11.3.2.1.23, 11.3.2.1.24, 11.3.2.1.25,11.3.2.1.26)	3000m of rising mains and connector mains	10
(11.3.2.2.5,11.3.2.2.6,11.3.2.2.8 , 11.3.2.2.9, 11.3.2.2.10, 11.3.2.2.11,11.3.2.2.12, 11.3.2.2.2.13, 11.3.2.2.14, 11.3.2.2.15, 11.3.2.4.6, 11.3.2.2.9,11.3.2.4.10,	Number of targeted reticulation infrastructure completed Mbizana, Umzimvubu)	13
11.3.2.2.3.2	% of Nyokweni / Bomvini Regional Water Supply Scheme Completed	1
11.3.2.3.3	% of Ntabankulu Sewer Upgrade completed	1
11.3.2.3.4	Water and Sewer connection to 471 RDP Houses	1
11.3.2.3.5	% Implementation of Ntabankulu WSIG programme completed	1
11.3.2.4.2, 11.3.2.4.3, 11.3.2.4.5, 11.3.2.4.7, 11.3.2.4.8, 11.3.2.4.9,	Km's of reticulation pipeline completed	6
11.3.2.4.11	% Completion of Mount Ayliff Water Project	1
	Total	46

Reliability

30. I was unable to obtain sufficient appropriate audit evidence for all four of the indicators relating to this programme. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements of the following indicators:

Performance indicator	Reported achievement	Audited Achievements
Number of water schemes maintained with 100% adherence to maintenance plan (11.3.3.3, 11.3.3.4, 11.3.3.1, 11.3.3.2.) (Ntabankulu, Umzimvubu, Matatiele, Mbizana)	187 water schemes maintained with 100% adherence to maintenance plan by 30 June 2017	129 water schemes maintained

Other matters

31. I draw attention to the matters below.

Achievement of planned targets

32. Refer to the annual performance report on pages x to x; x to x for information on the achievement of planned targets for the year and explanations provided for the under achievements of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 29 to 30 of this report.

Adjustment of material misstatements

33. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of programme 5: local economic development. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

Unaudited supplementary information

34. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

Report on audit of compliance with legislation

Introduction and scope

35. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance. The material findings on compliance with specific matters in key legislations are as follows:

Strategic and performance management

36. The performance management system and related controls were inadequate as they did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

Annual report and annual financial statements

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided, which resulted in the financial statements receiving a qualified audit opinion.

38. The annual performance report for the year under review did not include the performance of the municipal entity as required by section 46 (1) (a) of the Municipal Systems Act, 2000 (Act No.32 of 2000).

Budget management

39. Reasonable steps were not taken to prevent unauthorised expenditure of R33,5 million, as disclosed in note 49 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Expenditure management

40. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualified opinion paragraph.

41. Effective steps were not taken to prevent fruitless and wasteful expenditure of R378 644, as disclosed in note 50 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

42. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Asset management

43. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

44. Unauthorised, irregular and fruitless and wasteful expenditure was not investigated by the municipality to determine if any person is liable for the expenditure, as required by section 32(2)(a) and 32(2)(b) of the MFMA.

Procurement and contract management

45. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the municipality does not have a proper record keeping system.

46. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of supply chain management regulation 22(1) and 22(2).

47. Some competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with supply chain management regulation 29(2).

48. Sufficient appropriate audit evidence could not be obtained that the performance of contractors or providers was monitored monthly, as required by section 116(2)(b) of the MFMA.

49. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

50. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by supply chain management regulation 5.

Other information

51. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the separate financial statements, the auditor's report and those selected programmes presented in the annual performance report that have been specifically reported on in the auditor's report.

52. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

53. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate financial statements and the selected programmes presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
54. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

Internal control deficiencies

55. I considered internal control relevant to my audit of the separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
56. Leadership did not take full ownership of the general control environment and did not insist on daily disciplines to ensure efficiency and effectiveness in financial management, service delivery execution and compliance with legislations. Consequently the correct tone was not set to ensure that officials are held accountable for their actions through a consequence management programme.
57. Furthermore leadership did not investigate transgressions identified to take action against officials and promote where necessary and promote a high standard of ethics.
58. There was a prolonged vacancy (eight months) in the key position of chief financial officer, which resulted in leadership instability that undermined accountability. The absence of this leadership resulted in inadequate direction within the municipality to direct and guide its strategies and operations. In addition the support provided by consultants did not yield the desired results as leadership did not introduce all the required mechanisms to ensure that consultants deliver the expected outputs.
59. The municipality had an ineffective performance management system, which did not promote accountability and good human resource management.
60. The municipality did not implement and monitor the audit action plan. As a result, numerous internal control deficiencies identified in the previous year re-curred in the year under review.
61. The lack of daily, weekly and monthly financial discipline and monitoring throughout the financial year resulted in a large number of reconciliations, journals and corrections after year-end. In addition, leadership did not ensure that the consolidated and separate financial statements were consistent with the supporting documentation prior to its submission for audit.

62. There were no review and supervision processes to monitor compliance with all applicable legislation within the municipality. As a result, non-compliance with legislation was not effectively identified or prevented and municipal officials were not held accountable for transgressions.
63. The municipality did not have adequate risk management processes. As a result, there were no processes to identify all the risks to which the municipality was exposed and no mitigating controls for the risk that has been identified.
64. The internal audit unit did not effectively review internal controls and compliance with legislation. This was largely a result of the lack of co-operation from management and capacity shortages, in terms of skills and resources, in the unit.
65. The impaired functioning of the internal audit unit had an impact on the effectiveness of the audit committee.

Other reports

66. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
67. The special investigations unit (SUI) is investigating the procurement of goods and services that was in contravention of the supply chain management regulations. The investigation was still in progress at year-end.

AUDITOR - GENERAL

East London

6 December 2017



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